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Hiking the Minimum Wage Amounts to Bad Economics and Cynical Politics

(Democrats Trying Again to Change the Subject)

The motives behind Senator Kennedy's latest attempt to force votes on increasing the minimum wage by $1 over the next two years could hardly escape even the most naive observer.

- It's never a good time for bad policy, but some times are worse than others. Economically, a mandatory increase in the wage base can only have deleterious effects on what is daily demonstrated as a very precarious American economy.
  - Why would anyone want to throw yet more uncertainty into an economy that is entering the most precarious moment of the current expansion?
- Politically, the shameless demagoguery to which we will be subjected can only be viewed as a transparent attempt to divert attention from President Clinton's failings.
  - Why else would Senator Kennedy feel the need to force a vote on increasing the wage base at the same time that real average hourly earnings are growing at their fastest rate since this president has been in office?

Yet, as apparent as Senator Kennedy's motives are, it is no less important that the American public understand the economic ramifications of such market manipulation.

Artificially Increasing Prices, Including Wages, is Bad Economics

Senator Kennedy's minimum-wage-hike proposal is bad economics at every level.

Why Now? Real average hour wages are growing at the fastest rate — both in 1997 and again so far this year — since Clinton has been in office. Just last Saturday Clinton said, "Wages are growing at twice the rate of inflation — the strongest real wage growth in over 20 years." If the actions of the marketplace are to be overridden, doesn't it make sense to do so when wages aren't growing on their own?

- Recall that real average wages did not grow at all during the first two years of President Clinton's administration (remaining at $7.39 in constant 1982 dollars), yet, curiously — despite Democrats having control of both Congress and the White House — the minimum wage was not then increased.

Fewer Minimum Wage Jobs than Otherwise. It is axiomatic: Raising the price of a product will lower the demand for that product below the level it otherwise would have been.

- Unless Senator Kennedy has discovered a new law of economics — that labor is treated differently than every other commodity in the marketplace — then the result of raising the minimum wage will depress the demand for minimum wage workers below what it would have been without his proposed increase. Translation: some marginal workers will lose their jobs, and many will lose out on new jobs that will not be created.

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Relatively Fewer Jobs for Minorities and Women. The general rule of price has a particular impact: Those with the least skills and least experience — those who most are in need of minimum wage jobs in order to get on the first rung of the "employment ladder" — are affected most by this relative job loss.

- Minimum wage workers are disproportionately women, minorities and the young. Based on 1997 fourth quarter data: 64.3 percent of minimum wage workers are women; 20 percent are black (blacks comprise 13 percent of the U.S. population), and 18.3 percent are Hispanic (Hispanics make up 11 percent of the population).

Inefficient Shift of Resources Within Particular Market. Legislatively increasing the lowest wage rate means forcing resources into patterns they would not have otherwise assumed: An unnaturally higher rate of pay for the lowest level jobs means that resources must be shifted from more productive uses.

- For those employers who decide they cannot pay the mandatory increased wage, then some employees will lose their jobs and others will not be offered jobs (relative job loss), while employers lose the ability to maintain or expand their businesses in the most economically efficient manner. Consumers lose the service or product that would have been provided.

- If the employer pays the increased minimum wage, this money must be shifted from where it otherwise would have gone: 1) It might have gone to investment — which would have made the business more efficient and over time led to real wage growth for both the employees and employer; 2) It might have gone to paying higher-skilled employees increased wages — when more efficient employees are paid relatively less than they are worth, they will move to other businesses over time; or 3) It might have gone to profits — and without sufficient profits, employers may go out of business or move to other businesses over time.

- If the employer does pay the increased minimum wage, the cost of the product likely also will need to be increased. This would mean that consumers will pay more than the product is actually worth, and so will purchase less of it as a result. With less purchased, less will be produced and there will be at least relatively fewer people employed in the business.

An increased wage means the cost of the product likely also will be increased. Consumers then will face paying more than the product is actually worth, and so will purchase less of it as a result.

Inefficient Shift of Resources Within Overall Economy. The inefficient shift of resources within a particular business or sector of the economy has negative repercussions for the economy as a whole.

- The same shift of resources that takes place at the business (or micro) level, also takes place at the macro level. Resources are moved to accommodate the law's — rather than the market's — demands. Not the least of these costs is the diminished number of entry-level workers who otherwise would have been employed, initially at a lower wage, but placed in the position to receive training for more skilled employment opportunities in the future.

Pressure on Monetary Policy. As the above demonstrates, increasing costs in one area (minimum wage jobs) inevitably produces constraints in other areas. A reallocation of resources must result, and the decisions such transitions require are not pleasant. It is therefore natural that some will seek ways to avoid making such decisions. One way to avoid the hard choices of reallocation — the worst — would be to inflate the money supply (see analysis detailed in RPC paper, "The Link Between Minimum Wage Hikes and Inflation," 5/1/98).

- Inflating the money supply solves the problem of paying increased costs in one area without reallocating resources from others — because the money supply is increased to allow it. However — as the Carter years of "stagflation" (increasing inflation combined with stagnating growth) demonstrate — this is antithetical to real economic growth and debilitates every area of the economy.

- Increasing the minimum wage also creates a problem in gauging the proper level of the money supply. In order to judge the growth of the money supply, the Federal Reserve and the markets look directly at prices to determine if undue growth there signals an undue growth in the money supply itself — i.e., inflation. Increasing the minimum wage increases the difficulty the Fed and the markets have in discerning whether price growth is due to the legal requirement, economic demand, or a growth in the money supply. Considering the current economic concerns, this would be just another unneeded element of volatility.

Cynical Politics: Promising What Can't Be Delivered to Divert Attention

In light of its negative economics, the cynical politics of Senator Kennedy's minimum wage hike become patently transparent. He is willing to ask employees, employers, and consumers to take an economic risk in order to change the subject about his party's leader's political woes.

It has been only a year since the minimum wage was last raised. Over the last two years, Congress has twice (October 1, 1996 and September 1, 1997) increased the minimum wage, raising it from $4.25 to $5.15 per hour. Now just a year later, Senator Kennedy deems these increases to be inadequate and seeks again to raise it by another $1 to $6.15 per hour in two increments (January 1, 1999 and January 1, 2000). As RPC has already pointed out:

- Senator Kennedy's proposed $1 increase would be the largest ever over a two-year period, breaking his own record of 90 cents over two years that was just set;
- Only once before, during the "stagflation-era" Carter years of 1978-81, have there been four successive hikes;
- Senator Kennedy's currently proposed hike combined with the last two years' hike would equal the largest-ever hike in percentage terms — 45 percent.

Senator Kennedy's current attempt then begs a number of questions:

- ▸ How could it be wise to do this at the most vulnerable juncture of the current economic expansion?
- ▸ Why is it necessary to increase the minimum wage when real wages are already rising at the fastest rate since President Clinton took office?
- ▸ Why — when real wages were not growing at all during the first two years of Clinton's presidency and when Democrats controlled Congress — did Congress not hike the minimum wage then?
- ▸ Why increase the minimum wage before the effects of the last two hikes in the last two years have been fully evaluated?
- ▸ Why — when nations all over the globe are devaluing their currencies and these nations' companies are cutting their prices — would we want to raise the cost of the products America makes at home?

While it may be in the best interests politically of Senator Kennedy and President Clinton to distract attention from President Clinton's problems, it clearly is not in America's economic best interests to raise the minimum wage at this time.

Staff Contact: Dr. J.T. Young, 224-2946